

REPORT OF EXAMINATION
OF THE
DANIELSON INSURANCE COMPANY

AS OF
DECEMBER 31, 2005

Participating State
and Zone:

California

Filed October 25, 2006

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Los Angeles, California
September 1, 2006

Honorable Alfred W. Gross
Chairman of the NAIC Financial
Condition Subcommittee
Commissioner of Insurance
Virginia Bureau of Insurance
Richmond, Virginia

Honorable Gary L. Smith
Secretary, Zone IV-Western
Director of Insurance
Department of Insurance, State of Idaho
Boise, Idaho

Honorable John Garamendi
Insurance Commissioner
California Department of Insurance
Sacramento, California

Dear Chairman, Director and Commissioner:

Pursuant to your instructions, an examination was made of the

DANIELSON INSURANCE COMPANY

(hereinafter also referred to as the Company) at the primary location of its books and records,
444 West Ocean Boulevard, Long Beach, California 90802.

SCOPE OF EXAMINATION

The previous examination of the Company was made as of December 31, 2002. This examination covers the period from January 1, 2003 through December 31, 2005. The examination was made pursuant to the National Association of Insurance Commissioners' plan of examination. The examination included a review of the Company's practices and procedures, an examination of management records, tests and analyses of detailed transactions within the examination period, and an evaluation of the assets and a determination of liabilities as of December 31, 2005, as deemed necessary under the circumstances.

This examination was conducted concurrently with the examination of the Company's parent, National American Insurance Company of California and an affiliate Danielson National Insurance Company.

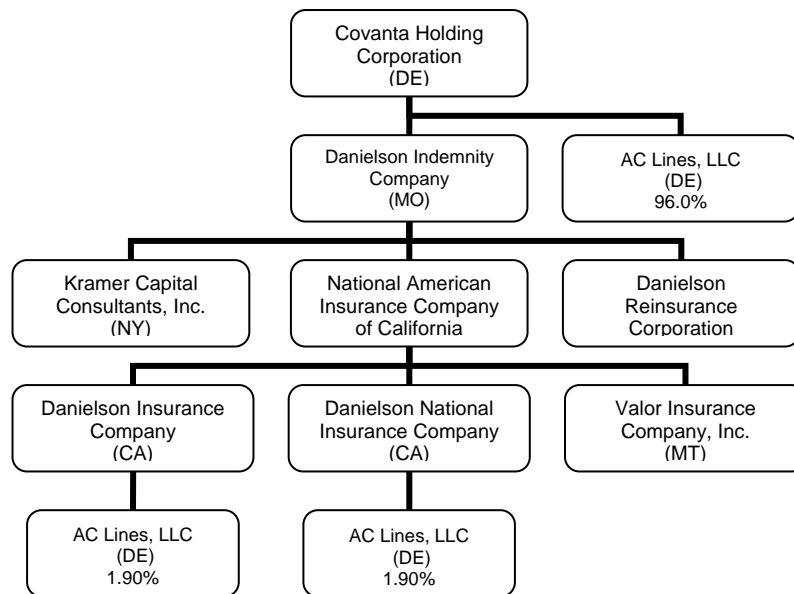
In addition to those items specifically commented upon in this report, other phases of the Company's operations were reviewed including the following areas that require no further comment: company history; corporate records; fidelity bonds and other insurance; officers', employees' and agents' welfare and pension plans; growth of company; business in force by states; loss experience; accounts and records; and sales and advertising.

SUBSEQUENT EVENTS

On July 6, 2006, the Company's parent submitted to the California Department of Insurance (CDI), preliminary comments on a proposed reorganization of the holding company structure, through the following transactions: (1) the merger of Danielson Insurance Company with and into National American Insurance Company of California and (2) the formation of a new holding company, in the form of a Delaware corporation, in order to allow for the creation and implementation of a stock award and option program. As of the date of this examination report, Danielson Indemnity Company has not received an approval of these transactions from the CDI.

MANAGEMENT AND CONTROL

The following abridged organizational chart, which is limited to the Company's parent along with its subsidiary insurance companies, depicts the Company's relationship within the holding company system:



Management of the Company is vested in a three-member board of directors elected annually. A listing of the members of the board and principal officers serving on December 31, 2005 follows:

Directors

<u>Name and Residence</u>	<u>Principal Business Affiliation</u>
Jon M. Schneider Signal Hill, California	President and Chief Financial Officer National American Insurance Company of California
Anthony J. Orlando New Providence, New Jersey	Chief Executive Officer Covanta Holding Corporation
Craig D. Abolt (**) Franklin Lakes, New Jersey	Chief Financial Officer Covanta Holding Corporation

Principal Officers

<u>Name</u>	<u>Title</u>
Jon M. Schneider	President and Chief Financial Officer
Kevin Grant	Vice President – Automobile Claims
Vahe Khachaturian	Vice President – Information Systems
Edward J. Lill (*)	Vice President – Tax of Corporations
Donald G. Hein	Assistant Vice President, Controller and Secretary

(*) Appointed as an officer on February 13, 2006

(**) Resigned on August 18, 2006 and replaced by Timothy Simpson on September 1, 2006

Intercompany Agreements

Executive, Professional, Administrative and Loss Adjustment Agreement: The Company is party to an expense sharing agreement with its parent National American Insurance Company of California (NAICC) and affiliates Danielson National Insurance Company (DNIC) and Valor Insurance Company, Inc. (Valor). Under the terms of the agreement, the Company and its affiliates are required to reimburse NAICC for executive services, professional services, and administrative expense items

on a pro-rata basis predicated on the parent's actual expense ratios. The Company and affiliates are obligated to pay amounts due within 30 days of the mandated quarterly billings to the parent. This agreement was submitted by NAICC in 2004 and it was approved by the California Department of Insurance (CDI), effective date of January 1, 2006. During the three years of the examination period the Company and its affiliates paid the following to NAICC:

Subsidiary	2003	2004	2005	Total
DNIC	\$1,095,200	\$412,310	\$380,176	\$1,887,686
DIC	1,098,012	633,232	581,800	2,313,044
Valor	50,000	138,000	148,000	336,000

Consolidated Federal Income Tax Agreement: Although there is no written agreement, the Company's taxable income is included in the consolidated federal income tax return of its ultimate parent, Covanta Holding Corporation (CVA). The Company submitted a formal written agreement in 2005 in which the CDI has reviewed and provided comments. The Company expects that a revised written agreement will be re-submitted to the CDI in late 2006.

TERRITORY AND PLAN OF OPERATION

As of December 31, 2005, the Company was licensed to transact multiple lines of property and casualty insurance in California, Idaho, Kansas and Oregon.

During the examination period, the Company did not write any direct business.

REINSURANCE

Intercompany Pooling

The Company and its parent, National American Insurance Company of California (NAICC), and its affiliate Danielson National Insurance Company (DNIC), are members of an Intercompany Pooling Agreement. Under the terms of the agreement, all business net of non-affiliated reinsurance is combined. The Company and DNIC each have a 10% participation interest in the pool, with NAICC having the remaining 80% interest. Effective January 1, 2006, the participation of the pool was modified with the Company retaining 40%, DNIC 50% and NAICC 10%. The Company's parent is planning a reorganization in which NAICC and the Company will merge. If and when the merger occurs, the pooling percentages will be shared equally by DNIC and NAICC.

Assumed

Assumed business is limited to the Company's participation in the above referenced Intercompany Pooling Agreement.

Ceded

The Company had no direct business and therefore did not cede any business.

FINANCIAL STATEMENTS

The financial statements prepared for this examination report include:

Statement of Financial Condition as of December 31, 2005

Underwriting and Investment Exhibit for the Year Ended December 31, 2005

Reconciliation of Surplus as Regards Policyholders
from December 31, 2002 through December 31, 2005

Statement of Financial Condition
as of December 31, 2005

<u>Assets</u>	<u>Ledger and Nonledger Assets</u>	<u>Assets Not Admitted</u>	<u>Net Admitted Assets</u>	<u>Notes</u>
Bonds	\$ 7,456,319	\$	\$ 7,456,319	(1)
Common stocks	269,839		269,839	
Cash and short-term investments	543,288		543,288	
Other invested assets	141,401		141,401	
Investment income due and accrued	89,652		89,652	
Net deferred tax asset	148,550,361	148,508,598	41,763	
Total assets	<u>\$ 157,050,860</u>	<u>\$ 148,508,598</u>	<u>\$ 8,542,262</u>	
<u>Liabilities, Surplus and Other Funds</u>				
Losses			\$ 1,323,621	(2)
Loss adjustment expenses			232,480	(2)
Unearned premiums			100,932	
Payable to parent, subsidiaries and affiliates			127,188	
Aggregate write-ins for liabilities			<u>67,000</u>	
Total liabilities			1,851,221	
Common capital stock		\$ 2,600,000		
Gross paid-in and contributed surplus		3,936,346		
Unassigned funds (surplus)		<u>154,695</u>		
Surplus as regards policyholders			<u>6,691,041</u>	
Total liabilities, surplus and other funds			<u>\$ 8,542,262</u>	

Underwriting and Investment Exhibit
for the Year Ended December 31, 2005

Statement of Income

Underwriting Income

Premiums earned		\$1,266,979
Deductions:		
Losses incurred	\$ 652,752	
Loss expense incurred	412,972	
Other underwriting expenses incurred	<u>488,725</u>	
Total underwriting deductions		<u>1,554,449</u>
Net underwriting loss		(287,470)

Investment Income

Net investment income earned	\$ 385,282	
Net realized capital gains	<u>7,425</u>	
Net investment income		392,707

Other Income

Net gain or (loss) from agents' or premium balances charged off	\$ <u>(8,231)</u>	
Total other income		<u>(8,231)</u>
Net income		<u>\$ 97,005</u>

Capital and Surplus Account

Surplus as regards policyholders, December 31, 2004		\$ 6,484,674
Net income	\$ 97,005	
Change in net unrealized capital gains	142,102	
Change in net deferred income tax	148,331,337	
Change in nonadmitted assets	(148,363,077)	
Aggregate write-ins for losses in surplus	<u>(1,000)</u>	
Change in surplus as regards policyholders for the year		<u>206,367</u>
Surplus as regards policyholders, December 31, 2005		<u>\$ 6,691,041</u>

Reconciliation of Surplus as Regards Policyholders
from December 31, 2002 through December 31, 2005

Surplus as regards policyholders, December 31, 2002, per Examination			\$ 5,439,318
	<u>Gain in Surplus</u>	<u>Loss in Surplus</u>	
Net income	\$ 717,723	\$	
Change in net unrealized capital gains	152,992		
Change in net deferred income tax	148,259,272		
Change in nonadmitted assets		148,211,264	
Surplus adjustments: paid in	400,000		
Aggregate write-ins for losses	<u> </u>	<u>67,000</u>	
Totals	<u>\$ 149,529,987</u>	<u>\$ 148,278,264</u>	
Net increase in surplus as regards policyholders			<u>1,251,723</u>
Surplus as regards policyholders, December 31, 2005, per Examination			<u>\$ 6,691,041</u>

COMMENTS ON FINANCIAL STATEMENT ITEMS

(1) Bonds

A review of the Company's bond investments disclosed that two of the bonds exceeded the limitations prescribed by California Insurance Code (CIC) Section 1197. CIC Section 1197 limits a company's investment of excess funds to any one borrower in an amount not exceeding 10% of capital stock and surplus or 1% of its admitted assets, whichever amount is greater. As of year-end 2005, the bonds owned by the Company exceeded these limitations by \$416,534 as shown below:

<u>Bond Description</u>	<u>12/31/05 Amortized Value</u>	<u>Limitation Per CIC Section 1197</u>	<u>Over Investment Amount</u>
IBM Corp.	\$ 752,727	\$ 669,104	\$ 83,623
SBC Communications Inc NT	1,002,015	669,104	<u>332,911</u>
Total over CIC Section 1197 limitation			<u>\$ 416,534</u>

It is recommended that the Company review its investment policies for compliance with CIC Section 1197 limitations.

(2) Losses and Loss Adjustment Expenses

Based on an analysis by a Casualty Actuary from the California Department of Insurance, the Company's loss and loss adjustment expense reserves as of December 31, 2005 were found to be reasonably stated and have been accepted for purposes of this examination.

SUMMARY OF COMMENTS AND RECOMMENDATIONS

Current Report of Examination

Bonds (Page 10): It is recommended that the Company review its investment policies for compliance with California Insurance Code (CIC) Section 1197 limitations.

Previous Report of Examination

Summary of Significant Findings (Page 2): It was recommended that the Company implement actions to improve its capital and surplus position as soon as possible. The Company received a \$400,000 contribution in 2003, which improved its capital and surplus position.

Management and Control – Intercompany Agreements (Page 5): It was recommended that the Company formally submit its amended Executive, Professional, Administrative and Loss Adjustment Agreement to the California Department of Insurance (CDI) for approval. It was also recommended that the Company formalize its tax arrangement with its parent through a written agreement. The Executive, Professional, Administrative and Loss Adjustment Agreement was submitted in 2004 and approved in 2006. The Tax Sharing agreement was submitted to the CDI in 2005 in which the CDI has reviewed and provided comments. A revised written agreement was re-submitted to the CDI on August 10, 2006. As of the date of this report, the Company has not received any comments or an approval.

Corporate Records (Page 6): It was recommended that the Company implement procedures to ensure compliance with CIC Sections 735, 1200 and 1201 and corporate bylaws. The Company has complied with this recommendation.

Accounts and Records (Page 8): It was recommended that the Company maintain documentation to support all financial statement accounts. The documentation should be prepared in sufficient detail as

to allow for a full and complete audit trail from the Annual Statement to individual records. The Company complied with this recommendation.

Bonds (Page 14): It was recommended that the Company review its investment policies for compliance with CIC Section 1197 limitations. The Company still has investments that exceeded the limitations.

ACKNOWLEDGEMENT

The courtesy and cooperation extended by the Company's officers and employees during the course of this examination are hereby acknowledged.

Respectfully submitted,

_____/S/_____
Samuel J. Salzman, CFE
Examiner-In-Charge
Senior Insurance Examiner
Department of Insurance
State of California